No. 7728.

In the United States
Circuit Court of Appeals
For the Ninth Circuit.

Regina Martz and A. J. Martz,
Petitioners,
vs.
Commissioner of Internal Revenue,
Respondent.

BRIEF OF PETITIONERS.

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TOPICAL INDEX.

PAGE

Petition to review decision of the Board of Tax Appeals.......... 3

Assignments of error.......... 4

Argument of petitioners.......... 5

Should petitioners be allowed to deduct inheritance taxes accrued and paid on May 10, 1928, from their income taxes for that year?.......... 5

Laws respecting taxes are construed in favor of the taxpayer.. 7

TABLE OF AUTHORITIES CITED.

Cases.

PAGE

Bankers Trust Co. v. Bowers, 295 Fed. 89.......... 7

Gould v. Gould, 245 U. S. 15, 62 L. Ed. 211.......... 7

Knowlton v. Moore, 178 U. S. 41, 44 L. Ed. 969.......... 7

United States v. Merriam, 263 U. S. 179, 68 L. Ed. 240.......... 8

Statutes.

Regulations 69, Article 131.......... 8

Revenue Act of 1926, Sec. 214 (a) (3).......... 8

Revenue Act of 1928, Sec. 703 (a).......... 5

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PETITION TO REVIEW DECISION OF THE BOARD OF TAX APPEALS.

There were two cases in the above matter which were consolidated for trial by an order duly made and entered before the Board of Tax Appeals. The matters involved relate to the income tax of each of the petitioners for the calendar year 1928. Petitioners are the son and daughter, respectively, of Elizabeth Martz, who died in Los Angeles, California, on November 30, 1927. Petitioner A. J. Martz was appointed administrator of her estate by the Superior Court of the state of California, in and for the county of Los Angeles.

On May 10, 1928, he paid to the state of California inheritance taxes due from himself and his sister upon

their inheritances in the sum of $427,043.16, one-half of that sum being the inheritance tax due on the inheritance of each of said petitioners.

Thereafter, and on May 12, 1928, a petition for partial distribution in the matter of the estate of Elizabeth Martz was filed, which was heard on May 29, 1928, at which time said petition for partial distribution was granted.

Thereafter, petitioners duly filed their tax returns for the calendar year 1928, wherein each of said petitioners claimed as a deduction from their gross income the sum of $213,521.58, theretofore paid to the state of California as inheritance tax in their mother's estate.

Upon an audit of their income tax returns, the deduction so claimed by each of said petitioners was disallowed and as a result thereof an additional income tax was assessed to petitioner Regina Martz in the sum of $5,496.20, and as to petitioner A. J. Martz in the sum of $14,581.53.

Assignments of Error.

Petitioners assign as error the following acts and omissions of the United States Board of Tax Appeals:

(1) The failure to allow as a deduction from each of the petitioners' gross income for the year 1928 the inheritance taxes paid on May 10, 1928, to the state of California, while the 1926 Revenue Act was still in force and effect.

(2) The failure to find that section 703, Revenue Act of 1928, allows the deduction claimed the distributees of the estate when claimed by them in their return and not claimed by the estate.

Argument of Petitioners.

The Revenue Act of 1926 provides that inheritance taxes paid are deductible only by the person making the payment, to wit: the beneficiary.

The particular question involved herein is:

Should Petitioners Be Allowed to Deduct Inheritance Taxes Accrued and Paid on May 10, 1928, From Their Income Taxes for That Year?

The Revenue Act of 1928 was signed on May 29, 1928, and was by its terms made retroactive to January 21, 1928. The Revenue Act of 1928, section 23 (c), provides that the amounts paid for inheritance taxes shall be allowed as a deduction only to the estate. However, inasmuch as the act was made retroactive, a saving clause was inserted in said act, section 703 (a), Revenue Act of 1928, which reads as follows:

> "In determining the net income of an heir, devisee, legatee, distributee, or beneficiary (hereinafter in this section referred to as 'beneficiary') or of an estate for any taxable year, under the Revenue Act of 1926 or any prior Revenue Act, the amount of estate, inheritance, legacy, or succession taxes paid or accrued within such taxable year shall be allowed as a deduction as follows:
>
> "(1) If the deduction has been claimed by the estate, but not by the beneficiary, it shall be allowed to the estate;
>
> "(2) If the deduction has been claimed by the beneficiary, but not by the estate, it shall be allowed to the beneficiary;
>
> "(3) If the deduction has been claimed by the estate and also by the beneficiary, it shall be allowed

> to the estate (and not to the beneficiary) if the tax was actually paid by the legal representative of the estate to the taxing authorities of the jurisdiction imposing the tax; and it shall be allowed to the beneficiary (and not to the estate) if the tax was actually paid by the beneficiary to such taxing authorities."

Petitioners claim that this clause governs the situation in this case. Petitioners paid the inheritance tax at a time when the 1926 Act was in effect. Therefore, under section 703, *supra,* if the deduction was claimed by the beneficiary but not by the estate, it shall be allowed to the beneficiary.

Petitioners, as beneficiaries, claimed the deduction, and the estate of Elizabeth Martz did not. Therefore, we submit that the petitioners have brought themselves squarely within this section.

In making the act retroactive to 1928, it would appear that Congress did not intend to penalize a citizen who had complied with the law in existence at the time in question, and before the 1928 Act took effect. It would certainly be unjust to hold that the citizen who complied with the law as it existed would not be entitled to a benefit placed in the law by Congress which intended to give the citizen the benefit of his act in compliance with the existing laws.

It may be said parenthetically that, in this case, the tax was paid before the retroacting statute was enacted and *not after*, and a statute controlling the situation was actually in existence when the payment was made. The payment was squarely made under that statute, and a corresponding right to deduct the tax payment from income tax liability had been thereupon at once established.

Public policy certainly frowns upon a condition in which one law renders inoperative something actually done under an antecedent law, and by which a right is created.

In the case of *Bankers Trust Co. v. Bowers*, 295 Fed. 89, the court said:

> "In interpreting a statute the construction placed thereon should avoid unjust consequences unless language compelled such a result, and a construction should be had with reference both to the history of the legislation and to other sections of the law with which it is then *para materia*."

The Supreme Court has also expressed the view that a reasonable interpretation of a statute should be adopted rather than one which would produce an inequality or injustice.

In *Knowlton v. Moore*, 178 U. S. 41 (44 L. Ed. 969. at p. 984), the court said:

> "Where a particular construction of a statute will occasion great inconvenience or produce inequality and injustice, that view is to be avoided if another and more reasonable interpretation is present in the statute."

Laws Respecting Taxes Are Construed in Favor of the Taxpayer.

If there be any doubt as to the meaning of language used in a statute levying tax the doubt must be resolved in favor of the taxpayer.

In the case of *Gould v. Gould*, 245 U. S. 15, 62 L. Ed. 211, the court said on page 213:

> "In the interpretation of statutes levying taxes it is the established rule not to extend their provisions, by

implication, beyond the clear import of the language used, or to enlarge their operations so as to embrace matters not specifically pointed out. In case of doubt they are construed most strongly against the government and in favor of the citizen."

In the case of *U. S. v. Merriam,* 263 U. S. 179, 68 L. Ed. 240, the court said, page 244:

> "On behalf of the government it is urged that taxation is a practical matter, and concerns itself with the substance of the thing upon which the tax is imposed, rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer."

The 1926 Revenue Act provided that the heir or beneficiary was the only person who could take a deduction from his or her income tax for inheritance taxes paid to this state.

Section 214 (a), (3) Revenue Act of 1926, and article 131, regulations 69, provide that inheritance taxes paid to a state or territory are deducted by the persons upon whom the tax is imposed, and in the state of California the said inheritance taxes are imposed upon the right or privilege to receive or to succeed to the property passing in the estate.

Most certainly Congress did not intend to make the provisions of the 1928 Act retroactive and thus deny to taxpayers, who had complied with all of the provisions of the then existing law and regulations, the right to a legal deduction theretofore granted and relied upon by the taxpayer in paying his taxes under said laws and regulations. It is contended herein that section 703 clearly applies in this case and allows the deduction to the heir paying the tax and claiming the deduction as was done in this case. If it were otherwise such interpretation would amount to the taking of property or the confiscation of money without due process of law. Any other interpretation would also make that portion of section 703 herein referred to meaningless, and Congress did not pass this part of the law without some purpose. The deduction was clearly within the exception provided by said section, and therefore should have been allowed.

In brief summary, permit us to say that:

This whole matter is very simple.

As in every case of the application of a law, fairness and equity should prevail in interpretation.

The authorities universally declare that if there be any reasonable doubt in the application of a law imposing taxes, the benefit should be given to the taxee.

In the instant case, $427,043.16 was paid for the beneficiaries by the estate administrator as tax to the California inheritance tax authorities. In other words, the money paid was the beneficiaries' money.

What was that money paid for?

It was paid as a tax imposed upon the property of, and owned by, and distributed to, the petitioners.

It was paid just as *all other* taxes are paid, by these petitioners, and by everybody else—paid to a governing body in satisfaction of its taxable right in the properties concerned.

On that very same property on which the petitioners paid the large sum of money in taxes just referred to, the same parties are today paying annual taxes in large sums, part of which taxes goes to the city of Los Angeles, part to the county of Los Angeles, and part to the state of California.

No question can be raised as to the right of these petitioners to deduct from income tax liability the annual taxes so paid on this same real property.

Why should objection be raised to the payment made by these same parties to the state of California in inheritance tax upon the identical property?

One of the two sets of taxes just referred to is paid annually. The other tax, which we are herein discussing, was paid at one time, and for a very large amount.

The principle is the same, however.

Here is a case where the country is dealing with its citizens. The country stands in the light of father. The father is supposed to be just to the children, and fair.

Splitting hairs is not befitting the dignity of either a great country or great tribunals.

The common-sense situation here is that the two beneficiaries have paid an enormous sum of money to the state of California for inheritance tax.

They now pay large sums of money *on the same property* every year—and are allowed such payments in their income tax returns.

Why are they not allowable in their income tax returns for the tax paid to the state as inheritance duty?

If the correct answer to the foregoing inquiry is that the law plainly and unequivocally ordains it, and that law is constitutional—the answer is sufficient, of course.

But where the law effective at the time of the tax payment to California declared that such payment entitled the payor to income tax deduction, and later a so-called retroactive statute conflicted with the then existing law, I contend that the doubt before referred to arises and the benefit should be given to petitioners herein.

Every constituent factor in common sense and fairness declares the foregoing to be true.

At the time this money was paid, May 10, 1928, the law (and only law)—that of 1926—was that the petitioners herein named could deduct the amount paid by them as state inheritance tax in making up their income tax return. And they paid on that basis. They paid an enormous sum—we know not at what difficulty.

That was the law, plain and unqualified, with no cloud on the horizon, or anything suggested to the contrary.

The petitioners complied with the law.

The very minute they complied with the law by paying that tax, they had the right to deduct from their income tax return the money so paid.

Such was the fixed condition at that time.

Later, on May 29, 1928, Congress enacted a new statute by the terms of which the estate was the party to deduct the inheritance tax so paid, but, in said act, which was made retroactive by its terms to January 1, 1928, a saving clause was inserted which provided, among other things, that:

> "If the deduction has been claimed by the beneficiary, but not by the estate, it shall be allowed to the beneficiary."

At the time that petitioners paid their tax to California, the 1928 Revenue Act had not been enacted, and the Statute of 1926 was in full force and operation.

At the very most, in favor of the government it may be said that there is a doubt as to whether, when an act has been lawfully done and a credit under law established (as was the case when the petitioners paid their California state inheritance tax), a later statute may constitutionally take away the full benefit from the parties who had complied with the law at the time.

Again we say that where there is a doubt, the doubt must be resolved in favor of the taxpayer.

The mere fact that the 1928 Revenue Act was made retroactive and purported to repeal the 1926 Act, could not

in fact change the effect of the 1926 Act prior to May 29, 1928, and to compliances with that 1926 law theretofore effected.

There is no question that the Revenue Act of 1926 was in effect (and the only law) at the time the petitioners paid their California state inheritance tax, and that the very moment they paid that tax they were entitled to corresponding reduction from the federal government in their income tax.

It is entirely against public policy for a sovereign state by one law to annul a pre-existing law and take away a right accrued under it.

When a taxpayer pays his tax, two things occur: One in the nature of a penalty, by being compelled to make the payment; the other in the nature of an advantage through the payment being made.

When the petitioners paid their enormous tax to the state of California, these same two conditions arose:

First, there was the penalty in having to pay the amounts. Petitioners paid those amounts, and satisfied the penalty.

Second, there was the compensation (trifling as it is) due *to* petitioners for having so paid.

The compensation was the right to deduct the amounts so paid from income tax.

With all the doubts in this matter, and with all the equities and fairness, it should not be held that the right

to compensation was taken away from petitioners after they had satisfied the demands of California and paid their tax, and had done the same with the expectation, and then knowledge, that they were to receive the slight compensating advantage of being able to deduct the amount so paid from their income tax liability.

We respectfully represent that the present case clearly shows that the petitioners are entitled to such deduction.

Respectfully submitted,

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